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No. 61

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

JOHN A. NELSON COMPANY, PETITIONER,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

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THE COURT PRESS, N. Y. C.

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Respondent assigns five particulars in respect of which it is asserted that the statutory requirements for the existence of a reorganization have not been met. It will not entail more than a fleeting consideration to dispose of each of these items.

(1) *No Plan of Reorganization.* Respondent's argument here is best put at rest by the following sentence from the opinion in the *Watts* case: "The plan of reorganization was the contract made and performed."

Respondent says that "sale" not "reorganization" was in the winds. To that end, respondent calls up a group of facts that do not advance the case on the merits, one way or another. It is of no consequence whether Elliott-Fisher Company invested cash or business property in the new company; nor does it matter how close to or dissimilar from petitioner's corporate charter was that of the new company, nor by whom the new company's charter terms were dictated. The only phase of consequence in this nar-

row approach is that the new company came into being to, and did, *succeed to the business* of petitioner by acquiring all of petitioner's assets.

Respondent then points to the use of the word "sale" at times in petitioner's minutes referring to the transaction. If nomenclature is to flourish, there must also be put into the hopper, the following from the same minutes: "The President ordered the Secretary to submit to the meeting a proposed agreement * * * providing for a *reorganization.*" That expression was repeated three times thereafter. In the agreement itself "sale" is not used, but rather "convey and transfer" (R. 16, 17). The Government in the deficiency letter described what took place as a *"sale merger"* (R. 8).

It is of course fundamental that names do not make facts, but that the real character of a transaction controls. It is interesting to observe, however, that in the *Pinellas* case, the Supreme Court uses "seller" and "purchasing company" as descriptive of participants in a reorganization, when it says:

> "Certainly we think that to be within the exemption, the *seller* must acquire an interest in the affairs of the *purchasing* company more definite than that * * *."

See also the *Barker* case, where the transaction was specifically described as a purchase and sale, but withal, was held to be a reorganization for tax purposes.

(2) *No "Stock or Securities" Received.* To sustain this branch of his argument, respondent seeks to have the statute construed so that its unequivocal

reference to "stock or securities" shall be effaced, and the doors barred to everything but the highly equivocal "evidence of ownership which gives a voice in the management". The very statement of the proposed upheaval in statutory language and concept, is sufficient to condemn it.

We need not, however, leave the matter in this way in the face of affirmative Congressional prescription that "stock or securities" was not to be metamorphosed into "*voting* stock or securities". We are here concerned with Section 203. In Section 203(i), Congress defined the word "control" as being the ownership of at least 80% of the "voting stock" and at least 80% of "all other classes of stock of the corporation". We thus have clear Congressional awareness of the difference between voting stock and other stock. In another part of the same section Congress delimited the field in which no gain or loss was to be recognized in reorganizations. Had Congress there desired to confine that aspect to cases involving only voting stock, it would have been perfectly natural, if not necessary, under the circumstances, that it expressly say so. Instead, it used the word "stock" without qualification or equivocation, thereby generically subsuming into the tax free status not only "voting stock" but also "all other classes of stock".

Preferred stock is of course stock, by the very nature of things. "From the legal point of view, it should be remembered that a preferred shareholder is just as much a shareholder, in contrast to the creditors of the corporation, as the common shareholder." Dewing, "Financial Policy of Corporations", p. 45.

The status of preferred stock strikes even more deeply. Under the laws of many of the states, preferred stock—regardless of voting power or other

features, but merely as a generic class—may be used as the sole fulcrum around which to pivot a statutory merger or consolidation. Thus, as to the laws of New Mexico, Parker's "Corporation Manual", 33rd Edition, p. 919, gives the following digest.*

> "* * * the consolidated corporation may purchase, acquire, hold and dispose of the stocks of other corporations of this state or elsewhere, and exercise in respect thereto all the powers of stockholders thereof, and may issue capital stock, *either common or preferred,* or both, to such an amount as may be necessary, to the stockholders of such merging or consolidating corporations in exchange or payment for their original shares, in the manner and on the terms specified in the agreement of merger or consolidation; which may fix the amount and provide for the issue of preferred stock based on the property of stock of the merging or consolidating corporations conveyed to the consolidated corporation, as well as upon money capital paid in." (Chap. 32, Sec. 219, New Mexico Statutes, Annotated, Compilation of 1929.)

Both petitioner and respondent join hands in acknowledging a statutory merger or consolidation as constituting a reorganization for income tax purposes. Respondent goes further and basically premises his defense, in the series of cases now before this Court, on the contention that only mergers and consolidations or transactions partaking of their nature qualify under Part (A) of the tax definition. In any event, with preferred stock, regardless of voting power, able to assume complete command of strict

* Preferred stock is expressly provided for as a merger or consolidation medium by Kansas (Revised Statutes of 1923, Section 17-301); Maryland (Bagby's Annotated Code of Maryland 1924, Article 23, Section 33); New Jersey (Compiled Statutes, Section 106); New York (Stock Corporation Law, Section 86, as amended by L. 1931, c. 55).

mergers and consolidations, it automatically follows that such stock can certainly hold the fort in transactions "which in strictness can not be designated as either merger or consolidation" (*Pinellas* case). Preferred stock must hence represent the quality of "stock or securities" that may constitute the predicate for reorganization in the tax sense.

(3) *Large Proportion of Cash to Stock.* Respondent revives the argument about sale versus reorganization on the basis of the large cash amount involved. The statute itself is the complete answer to this argument. Section 203(e) provides for the continued status as a reorganization, though in addition to stock or securities there is received "other property or money". The quantum of other property or money is in no way limited or prescribed. What is prescribed is that the money cannot be received tax-free. To the extent that it represents gain, it is immediately taxed either to the receiving corporation, or, if distributed by the latter, then to its stockholders. There is therefore, no tax exemption or deferrment so far as the money is concerned. But the fact that money is involved, in no way either enhances or detracts from the reorganization status under the statute, regardless of amounts or proportions.

The definition of reorganization in the Revenue Act of 1934—Section 112 (g)(1)—is of no small interest in this respect, in view of its antecedents and legislative history. From Appendix B and D of respondent's brief in the *Minnesota Tea Co.* case (now pending before this Court), it is clear that the subject of reorganizations was comprehensively reviewed by and for Congress in the embryonic stages of the Revenue Act of 1934. The Joint Committee

on Internal Revenue recommended the complete elimination of the reorganization section from the Act, pointing out, among other things, how the section provided a basis for tax avoidance. The Treasury recommended, and Congress agreed merely to a redraft of important phases of the reorganization provisions. It is noteworthy that as thus redrafted, Congress retained the idea of reorganization where substantially all the assets of a corporation are acquired for stock and money. The feature new to the Revenue Act of 1934 was that the stock must be "voting stock". But the point here material is that no limitation whatsoever was placed on the proportion of money that may be received in relation to stock. To the contrary, the statute provided that all that need be involved is "a part" of the voting stock. One share of stock and an unlimited amount of cash would still qualify as a reorganization under a definition that was drafted after years of experience with cases precisely like those now before this Court. It is thus obvious that no meritorious argument can be advanced based on the quantum relationship between stock and money, as a determinant of the essence of reorganization.

(4) *All Liabilities Not Assumed.* The new company assumed all the liabilities reflected by petitioner's balance sheet and assumed all disclosed contracts of petitioner and its subsidiaries (R. 17). Because liability was not assumed for the 1926 bonus to two of petitioner's employees and for the 1926 corporate income tax (R. 19-20), respondent argues that this derogates from merger or consolidation.

In the first place, the statute concerns itself solely with the acquisition of substantially all the assets. No requisite is prescribed as to assuming any liabili-

ties, no less all the liabilities. Furthermore, we are agreedly not dealing with a technical merger or consolidation. We qualify, if we qualify at all, by virtue of the parenthetical clause in the statute that expands the field beyond strict mergers or consolidations. The highly limited reservation of liabilities in this case cannot therefore usurp unto itself any significance.

(5) *No Dissolution.* This phase has already been fully covered in petitioner's brief (pp. 17-21). Respondent points to the change of name, provided for in the agreement with Elliott-Fisher Company, as contemplating petitioner's continued existence. In point of fact, however, the change was to enable the new company to use petitioner's name (R. 19). If anything, therefore, this shows absorption and succession from the old company to the new.

Again the conclusion is reached that the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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Counsel for Petitioner.

November, 1935.